

Date September 14, 1993



To Dan Fox

From Ed Hogan

Memorandum

Subject Interchange Compliance Program

Copies To Carl Munson, Jack Wright

I read your memo regarding the Interchange Compliance Program in which you disagreed with the policy of allowing an issuer to receive a higher interchange fee as a result of the issuer's magnetic stripe not being read to effect the transaction. I certainly can understand your concerns and quite frankly can be sympathetic with either favoring an issuer or an acquirer in these situations.

The fact of the matter is that MasterCard has to make a decision to favor either the issuer or the acquirer. Either way, the other party will be angered and the only question is which position best fits MasterCard's strategy. Initially, we were going to favor the acquirer, but we then realized that we would likely create a competitive disadvantage with issuers, vis-a-vis Visa. So we enforced the rule. There is really no good middle ground to this proposition. Either you favor acquirers or you favor issuers. Visa has favored issuers and has taken the blunt of the merchant and acquirer abuse; not dissimilar to that which we will likely reap. However, if we favor the acquirers we will the only substitute the anger of the issuers who can likely hurt us much more by not issuing our cards. This is truly a rock and a hard place.

I do not think that it is realistic to suggest issuers would actually issue cards that had magnetic stripes that could not be read so that they could receive a higher interchange fee. If you still believe that there is such a possibility, there are a number of programs that could be put in place to catch such eventualities.

Your recommendation to monitor activity and fine delinquent members and/or maneuver their quarterly assessment rate, is not an adequate substitute for the increased interchange fee amount. MasterCard needs to decide to favor the acquirers or the issuers for magnetic stripe failure. There is no way to determine whether it was the terminal, card, or just plain circumstances that caused the magnetic stripe to fail for a particular transaction. It is within our authority to enforce our rules for acquirers as a condition of our "rebate" program. It is equally reasonable for us not to have such a rule as the one there is for magnetic stripe reads. The decision is ours, or in fact, the decision belongs to the U.S.

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**GOVERNMENT
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Region. If you decide to favor the acquirer, then continuing to improve delinquency is a good idea, along the lines you suggested. However, it's not a substitute for reimbursing the issuer and should not be considered as such.

The only thing I can tell you is that if you're going to change this policy it is imperative that you declare your intentions now. Because we cannot go on discussing this any longer and the ESG group is about to go to significant trouble to require that acquirers implement a "trace" type number into their clearing record at the MIP level. The U.S. group should declare itself one way or the other, now.

For my part, I would opt to dunn acquirers and reimburse issuers. However, that does not detract from the truth or the concerns you express about the unfairness of this policy to acquirers/ merchants, and the level of complaints that we will receive. You won't get an argument from me either way.

EH/sr



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